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Remedies for Breach of the Pre-contract Duty of Disclosure in Chinese Insurance Law

Zhen Jing*

Chinese Insurance Law imposes on the insured a duty to disclose material information prior to the conclusion of the contract. The duty is limited to the scope and extent of the insurer's inquiry and to the insured's actual knowledge. The insurer may rescind the contract if the insured failed to comply with the duty intentionally or by gross negligence and the undisclosed fact is material. This article considers the remedies for breach of the duty, examines the way in which courts determine whether a breach is intentional or by gross negligence, discusses deficiencies of the remedies, and recommends adopting the doctrine of proportionality for insurer's liability for losses.

Keywords: *Insurance Law, Duty of disclosure, Misrepresentation, Remedies, Types of breach, Proportionality, Causation, Chinese law, English law.*

1. Introduction

An insurance contract is a contract based on the utmost good faith.¹ In the pre-contract period the principle of utmost good faith creates well-established duty owed by the insured to disclose material facts and to refrain from making untrue statements when negotiating the contract.² The insurer usually knows nothing about the subject of the insurance, while the person who comes to the insurer to ask him to insure knows everything, thus it is the duty of the person (the insured) to make a full disclosure to the insurer all the material circumstances. On the basis of the information provided by the insured, the insurer can decide whether to accept the risk and, if so, on what terms.

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¹ S.17 of the Marine Insurance Act 1906. For more on history and development of the doctrine of disclosure in English law, see R. Merkin, *Colinvaux's Law of Insurance* (9th edn., Sweet & Maxwell, 2010) para.6-002.

² See J. Birds, B. Lynch and S. Milnes, *Macgillivray on Insurance Law* (12th edn., Sweet & Maxwell, 2012) para. 17-003.

In all jurisdictions, the insured is obliged to disclose to the insurer all material information prior to the conclusion of the contract.³ In China, the current law relating to the insured's duty of disclosure or representations is provided in art.16 of the Insurance Law 2009,⁴ which states "When concluding an insurance contract, the insurer may raise questions concerning relevant details of the insured subject matter or of the insured. The proposer shall truthfully disclose such details to the insurer."⁵ Where the proposer (the insured)⁶ failed to comply with the duty of disclosure, the insurer can have remedies which depend on the degree of the insured's fault and consequences of the breach.⁷

This paper considers the remedies available to the insurers when the insured is in breach of the duty of disclosure in Chinese Insurance Law as compared with those in English law. It examines the way in which Chinese courts determine whether a breach of the duty of disclosure is intentional or due to gross negligence. Meanwhile, deficiencies of the law in respect of the remedies are critically discussed, and recommendations are figured out for introducing the doctrine of proportionality for the insurer's liability in the case of a grossly negligent non-disclosure, and for definitions of the terms of intentional and grossly negligent breach of the duty of disclosure.

2. A brief overview of the duty of disclosure

Inquiry disclosure

The Insurance Law adopts the way of inquiry disclosure, i.e. "asking and answering" questions in the proposal form.⁸ According to art.16(1) of the Insurance Law that the insured is required to disclose only the information asked by the insurer on the proposal form, while

³ For examples, s.18 of Marine Insurance Act 1906 (UK), s.21 of the Insurance Contracts Act 1984 (Australia), s.19 of German Insurance Contract Act 2008, and art.16 of Chinese Insurance Law 2009.

⁴ The Insurance Law of the People's Republic of China was enacted by the National People's Congress in 1995 which was the first comprehensive legislation on insurance in China which consists of insurance contract law and insurance regulation. To meet the commitment to the WTO, the Insurance Law 1995 was amended in 2002 mainly on insurance regulation, and insurance contract law was essentially not changed in 2002 version. The Law was again amended in 2009. Both contract law and regulation were amended substantially.

⁵ Art. 16(1) of the Insurance Law.

⁶ The person who makes an application for insurance is called the proposer. When the insurer has agreed to underwrite the risk, the proposer is now called the insured or the policyholder. This article uses the term "the insured" for the proposer or the insured.

⁷ Art. 16(4) and (5) of the Insurance Law.

⁸ In contrast to the inquiry disclosure in non-marine insurance, voluntary disclosure is adopted for marine insurance. Art.222 of the Chinese Maritime Code 1992 provides "Before the contract is concluded, the insured shall disclose to the insurer material circumstances which the insured has knowledge of or ought to have knowledge of in his ordinary business practice and which would influence the insurer in deciding the premium or whether he agrees to insure or not".

the insurer may not be allowed to rescind the contract on the ground that the insured did not disclose something material which is beyond the scope of the questions raised in the proposal form even if it is material.⁹

The Supreme People's Court of China (the SPC) enacted its Second Interpretation on Certain Questions Concerning the Application of the Insurance Law of the Peoples' Republic of China (the SPC Interpretation).¹⁰ As to the duty of disclosure, the SPC made it clear that "The insured's duty of disclosure is limited to the scope and content of the insurer's inquiry; where the insurer and the insured dispute on the scope and content of the inquiry, the onus of proof rests upon the insurer."¹¹ Accordingly, the insured is deemed to have performed the duty of disclosure if he has truthfully answered the questions in the proposal form. He has no duty to volunteer information to the insurer even if the information is material.

Sometimes a situation may occur where the insured has voluntarily disclosed some information without being inquired by the insurer, but the information is untrue and misleading. Neither the Insurance Law nor the SPC Interpretation provides any rule for handling this situation. The High People's Court (HPC) of Beijing City provided a guiding rule that if the insured has voluntarily disclosed some information without being inquired by the insurer and written down the information on the proposal form, it is deemed that the insurer has made inquiry as to that information and the insured owes the duty to disclose that information truthfully.¹² This issue has yet to be resolved by the SPC in the future.

In English law, the Consumer Insurance (Disclosure and Representations) Act 2012 (CIDRA)¹³ abolishes the duty of consumers to volunteer material facts. Instead, the

⁹ See Z. Jing "Insured's duty of disclosure and test of materiality in marine and non-marine insurance laws in China" [2006] JBL 681.

¹⁰ The Supreme People's Court Second Interpretation on Certain Questions Concerning the Application of the Insurance Law of the Peoples' Republic of China was passed by the Judgement Committee of the Supreme People's Court on 6 May 2013 and became effective on 8 June 2013. The SPC Interpretation clarifies ambiguities of the Insurance Law and puts forth detailed rules for the Insurance Law. According to articles 5 and 6 of the Stipulation of the Supreme People's Court on the Judicial Explanation (2007 No.12), the Supreme People's Court stipulation, judicial explanation or decision have legal force. This means that the Supreme People's Court stipulation, judicial explanation or decision is one of the legal sources in China.

¹¹ Art.6(1) of the SPC Interpretation.

¹² Art.8 of the Guidance of the High People's Court of Beijing City Concerning Questions of How to Deal with Insurance Disputes 2005. It must be noted the guidance enacted by the High People's Court is only to guide the lower courts rather than to bind them. These guiding rules have no legal force.

¹³ Consumer insurance contract means a contract of insurance between (a) an individual who enters into the contract wholly or mainly for purposes unrelated to the individual's trade, business or profession, and (b) a person who carries on business of insurance and who becomes a party to the contract by way of that business; consumer means the individual who enters into a consumer insurance contract, or proposes to do so.

consumers are required to take reasonable care not to make a misrepresentation.¹⁴ This means that the consumers must take reasonable care to answer insurer's questions fully and accurately. If consumers do volunteer information, they must take reasonable care to ensure that the information is not misleading. For non-consumer insurance,¹⁵ the duty of fair presentation is now provided in s.3 of the Insurance Act 2015 (UK).¹⁶ The major element of a fair presentation is a duty of disclosure which provides two ways to satisfy the duty of disclosure (voluntary disclosure). S.3(4)(a) effectively replicates the disclosure duty in s.18(1) of the Marine Insurance Act 1906 (UK). Its key features are that the insured must disclose "every material circumstance" which the insured "knows or ought to know". The second way to satisfy the duty is intended to operate where the insured has failed to satisfy the strict duty in s.3(4)(a) but has nevertheless disclosed enough information. Under s.3(4)(b), the insured has satisfied the disclosure duty if he has disclosed sufficient information to put a prudent insurer on notice that the insurer must make further enquiries which, when answered, would reveal material circumstances which the insured knows or ought to know. S.3(4)(b) represents the key change to the duty of disclosure. It reflects the trend in case law of accepting the fact that it may not be possible or necessary for every material circumstance to be disclosed¹⁷.

In summary to English position in respect of duty of disclosure, for consumer insurance, inquiry-based disclosure (i.e. representation) is adopted in the CIDRA; while for non-consumer insurance, voluntary disclosure has been preserved in the Insurance Act 2015, but the strictness of the duty of voluntary disclosure has nevertheless been mitigated to some extent by s.3(4)(b) of the Insurance Act 2015.

Insured actual knowledge

Art.16(1) of the Insurance Law requires the insured to disclose material information to the insurer at the time of the contract, but does not give any provision about the insured's knowledge. The SPC has provided a clear rule in respect of the insured's knowledge, which states that "When entering into an insurance contract, circumstances about the subject matter of insurance or of the insured which are to be truthfully disclosed by the insured as required

¹⁴ S.2(2) of the CIDRA.

¹⁵ A non-consumer insurance contract means a contract of insurance that is not a consumer insurance contract. This includes insurance for charities, micro-businesses and small or medium enterprises, as well as large risks, marine insurance and reinsurance.

¹⁶ The Insurance Act 2015 can be found at <http://www.legislation.gov.uk/ukpga/2015/4/contents/ebacted>.

¹⁷ For example, *CTI v Oceanus* [1984] 1 Lloyd's LR 476; *Garnat Trading and Shipping v Baominh Insurance Corporation* [2011] EWCA Civ 773.

by art.16(1) the Insurance Law are those which the insured actually knows.”¹⁸ So the current law position is that the insured is obliged to disclose only what he actually knows, not what he ought to know. Constructive knowledge is irrelevant.

Test of materiality

By virtue of art.16(2) of the Insurance Law,¹⁹ a material fact is a fact which “shall sufficiently influence the insurer's decision on whether or not he will accept the insurance or raise the premium rate”. The term “sufficient influence” can also mean “decisive influence”.²⁰ The term “insurer” mentioned in art.16(2) denotes a “prudent insurer” or “reasonable insurer”.²¹ So the test of materiality in Chinese Insurance Law can be established as a “prudent insurer decisive influence” test: an insurer would not have entered into the contract or would have raised the premium rate had he known the fact undisclosed or misrepresented by the insured.²²

In English law, the CIDRA abolishes the “the mere influence prudent insurer” test of materiality; the concept of “inducement”²³ has been preserved. It means that the insurer must show that without the misrepresentation he would not have entered into the contract, or would have done so on different terms.²⁴ The inducement approach has also been preserved in s.8(1) of the Insurance Act 2015 for non-consumer insurance.

3. Types of non-disclosure and remedies

Rescission of the contract

Non-disclosure or misrepresentation can be made intentionally, by gross negligence, negligently or innocently. The Insurance Law provides different remedies for breach of the duty of disclosure depending on the types of the breach. The insurer is entitled to rescind the contract where the insured fails to comply with the duty of truthful disclosure intentionally or by gross

¹⁸ Art.5 of the SPC Interpretation.

¹⁹ Art.16(2) of the Insurance Law provides “The insurer shall have the right to rescind the insurance contract where the proposer fails to fulfil the obligation of truthful disclosure ... intentionally or by gross negligence so that the failure of disclosure or misrepresentation shall sufficiently influence the insurer's decision on whether he will accept the insurance or raise the premium rate.”

²⁰ See Z. Jing “Insured's duty of disclosure and test of materiality in marine and non-marine insurance laws in China” [2006] JBL 695.

²¹ Ibid. See also Z.N. Liu, *Life Insurance Law and Practice* (Law Press China, 2012), p230.

²² Ibid.

²³ *Pan Atlantic Insurance Co Ltd v Pine Top Insurance Co Ltd* [1995]1 A.C.501, [1994] 3 W.L.R. 677; [1994] 3 All E.R. 581, HL.

²⁴ S.4(1)(b) of the CIDRA.

negligence so that the failure of disclosure or misrepresentation shall sufficiently influence the insurer's decision on whether he will accept the insurance or raise the premium rate.²⁵ It is implied in art.16 of the Insurance Law that for an innocent or mere negligent non-disclosure or misrepresentation the insurer is not entitled to rescind the contract even if the undisclosed information is material. It must be noted that the insured's right of rescission shall lapse where the insurer does not exercise it 30 days after having learned of the insured's breach of the duty, or over two years from the date of formation of the contract.²⁶

In Chinese law, an insurer is not allowed to rescind the contract, unless the following conditions are met: (i) the insurer must have made inquiries about the relevant facts in questions raised in the proposal form prior to the conclusion of the contract;²⁷ (ii) the insurer must actually knew the relevant facts;²⁸ (iii) the insured failed to perform the duty intentionally or by gross negligence;²⁹ (iv) the undisclosed information must be material in that it sufficiently influences the insurer's decision on whether or not he will accept the insurance or raise the premium rate;³⁰ (v) when concluding the contract, the insurer did not know that the insured had failed to provide truthful information;³¹ and (vi) the insurer's right of rescission of the contract must be exercised within 30 days after having learned of the insured's breach of the duty, or within 2 years from the data of conclusion of the contract.³²

In English law, under CIDRA, if a consumer breaches the duty to take reasonable care not to make a misrepresentation,³³ and this misrepresentation induces the insurer to enter into the contract, the insurer will have a remedy. The nature of the insurer's remedy depends on nature of the consumer's misrepresentation and, in particular, the consumer's state of mind.

²⁵ Art.16(2) of the Insurance Law.

²⁶ Art.16(3) of the Insurance Law provides "The right of rescission provided in the preceding paragraph shall lapse where the insurer does not exercise it thirty days after he knows that there is the cause for rescission. Where over two years have passed from the date of formation of the contract, the insurer may not rescind the contract; where an insured event occurs, the insurer shall be liable for making indemnity payment or paying insurance benefits." For more on the time limits for the insurer's right of rescission of the contract, see Z. Jing "Incontestability provisions in insurance law and policies" [2016] JBL 253-288.

²⁷ Art.16(1) of the Insurance Law, and art.6(1) of the SPC Interpretation.

²⁸ Art.5 of the SPC Interpretation.

²⁹ Art.16(2) of the Insurance Law.

³⁰ Ibid.

³¹ Art.16(6) of the Insurance Law provides "Where the insurer knows that the proposer fails to make a truthful disclosure at the time of entering into a contract, the insurer may not rescind the contract; where an insurer event occurs, the insurer shall be liable for making indemnity payment or paying insurance benefits."

³² Art.16(3) of the Insurance Law.

³³ S.2(2) of the CIDRA.

For a deliberate or reckless misrepresentation,³⁴ the insurer is entitled to avoid the contract and treat the contract as if it never existed and refuse all claims. The insurer may also retain the premium unless it would be unfair to do so.³⁵ In contrast, for an honest and reasonable misrepresentation, the insurer is not entitled to rescind the contract and must pay the claim.

For a careless misrepresentation,³⁶ the insurer's remedies are based on what he would have done if the consumer had complied with the duty to take reasonable care not to make a misrepresentation. If the consumer would not have entered into the contract on any terms, the insurer may avoid the contract and refuse all claims, but must return the premium paid. If the insurer would have entered the contract on different terms, the contract may be taken to include those different terms. If the premium would have been higher, the insurer must reduce proportionately the amount to be paid on a claim.³⁷ For treatment of the contract for the future, where the insurer would have contracted on different terms or for a higher premium (or both): (a) in non-life insurance, either side is entitled to terminate future cover on reasonable notice; (b) for life insurance, the insurer is not allowed to terminate the contract and must continue the policy either on the existing terms or on amended terms.³⁸

Under the Insurance Act 2015, for non-consumer insurance, the insurer has a remedy for a breach of the duty of fair presentation if the insurer can show that but for the breach it would not have entered into the contract at all, or would have done so only on different term.³⁹ The insurer may avoid the contract for deliberate, reckless, or even innocent breach of the duty if the insurer can show inducement.

Remedies in relation to pre-rescission losses and premium paid

The legal consequences in respect of losses which occurred prior to rescission of the contract and of premium paid by the insured depend on whether the breach of the duty of disclosure is intentional or by gross negligence.

³⁴ A misrepresentation is deliberate or reckless if the consumer (a) knew that it was untrue or misleading, or did not care whether or not it was untrue or misleading, and (b) knew that the matter to which the misrepresentation related was relevant to the insurer, or did not care whether or not it was relevant to the insurer (s.5(2) of CIDRA).

³⁵ Para.2, schedule 1 of CIDRA.

³⁶ A misrepresentation is careless if it is not deliberate or reckless (s.5(3) of CIDRA).

³⁷ Paras 3 to 8, schedule 1 of CIDRA.

³⁸ For more, see J. Birds, B. Lynch and S. Milnes, *Macgillivray on Insurance Law* (12th edn., Sweet & Maxwell, 2012) paras 19-047 and 19-048.

³⁹ S.8 of the Insurance Act 2015.

For intentional non-disclosure or misrepresentation, the insurer is not liable for losses that occurred prior to the rescission of the contract whether or not the loss is caused by the undisclosed facts, and shall not refund the premium.⁴⁰ The insurer may rescind the contract *ab initio*, as if the insurer has never been at risk under the policy. The retroactive effect of a rescinded contract seems to be unilateral to the insurer in the sense that only the insurer is entitled to demand restoration of *status quo ante*, but the insured is not entitled to a recovery of premium paid. The retention of the premium by the insurer can be regarded as a penalty to the insured for his intentional breach of the duty of disclosure.

In the case of non-disclosure or misrepresentation by gross negligence, there are two different remedies, depending on whether or not the fact undisclosed or misrepresented has a material impact on the occurrence of the insured events. The insurer is not liable for losses that occurred prior to the rescission of the contract if the fact undisclosed or misrepresented has a material impact on the occurrence of the insured events, but the insurer must refund the premium.⁴¹ In this case, the rescission of the contract is retroactive. If there is no causal connection between the occurrence of the insured event and the undisclosed fact, the insurer is liable for losses that occurred prior to the rescission of the contract. In this case, the rescission of the contract is not retroactive, but prospective, i.e. from the moment of rescission.

The question whether or not the rescission of the contract is retroactive is important in some circumstances. If, for example, the insured is paid for a loss under a health policy, and then, on the occasion of a second loss, the insurer discovers that there has been an intentional or a grossly negligent non-disclosure or misrepresentation by the insured, it is very material to know the moment in time from which the policy is deemed to be rescinded. If the contract is rescinded only from the moment of rescission, the insured would keep the money paid to him for his earlier claim. This is so in the case of a grossly negligent non-disclosure which has no material impact on the occurrence of the insured events. If the contract is rescinded *ab initio*, and not merely for the future, the insurer should be deemed to have never been at risk, the insured should repay the money to the insurer. This is so for the case of an intentional non-disclosure,

⁴⁰ Art.16(4) of the Insurance Law provides “where the proposer fails to perform his duty of disclosure and truthful representation of information to the insurer intentionally, the insurer shall not be liable for making indemnity payments or paying insurance benefits in connection with the insured events that occur prior to the rescission of the contract, and shall not refund the premium”.

⁴¹ Art.16(5) of the Insurance Law provides “where the failure of the proposer to perform his duty of disclosure and truthful representation by gross negligence has a material impact on the occurrence of the insured events, the insurer shall not be liable for making indemnity payments or paying insurance benefits in connection with the insured events that occur prior to the rescission of the contract, but he shall refund the premium”.

and also for the case of a grossly negligent non-disclosure which has a material impact on the occurrence of the insured event.

Determination of intentional or grossly negligent breach of the duty

As discussed above, the legal consequences for intentional or grossly negligent breach of the duty of disclosure are different in respect of liability for losses which occurred prior to rescission of the contract and for return of premium paid by the insured. There is a continuum that runs from simple negligence through gross negligence to intentional misconduct. Recklessness, or reckless disregard, lies between gross negligence and intentional harm.⁴² It is not easy to clearly draw a line between mere negligence and gross negligence, but it is necessary and important to distinguish intentional act and grossly negligent act, mere negligent and grossly negligent act, as different remedies are applicable to different types of breach.

The Insurance Law does not define the term of “intentional”. The definition of the term “intentional” is provided in the Criminal Law of China.⁴³ An intentional crime refers to an act committed by a person who clearly knows that his act will entail harmful consequences to society but who wishes or allows such consequences to occur.⁴⁴ By analogy, a non-disclosure or misrepresentation can be deemed to be intentional if the insured actually know the fact or information but does not disclose to the insurer or provides an untrue answer to the insurer’s question, with a culpable state of mind that the insurer would act on the fact or information and enter into the contract which the insured would otherwise not have been able to enter into.

Intention is a state of the subjective mind of the insured. Unless the insured admits, his subjective mind of intention can only be reflected and judged by the fact of the case in question. In judicial practice, the courts usually treat a breach of the duty of disclosure as an intentional one if the insured (i) knew the existence of the fact in question,⁴⁵ (ii) knew that the

⁴² *Saba v Air France* (1996) 78 F. 3d 664 (D.C. Cir), 667.

⁴³ Criminal Law of the People's Republic of China was adopted by the Second Session of the Fifth National People's Congress on July 1, 1979, amended by the Fifth Session of the Eighth National People's Congress on March 14, 1997, promulgated by Order No.83 of the President of the People's Republic of China on March 14, 1997, and effective from October 1, 1997.

⁴⁴ Art.14 of the Criminal Law of China.

⁴⁵ According to art.5 of the SPC Interpretation, the insured’s knowledge refers to actual knowledge and constructive knowledge is irrelevant.

fact was relevant to the insurer,⁴⁶ and (iii) knew that his answer to the question was untrue or misleading, with the intention that the insurer acted on it in the sense that it induced the insurer to enter into the proposed contract. For example, in *Mrs Wang v the Life Insurance Company Yuxi Branch*,⁴⁷ the insured effected a critical illness policy on her daughter's life on 26 October 2010. The life insured was diagnosed with acute myelogenous leukaemia on 11 October 2010, but the insured gave a negative answer to the question in the proposal form which asked "Have the life insured been diagnosed with leukaemia, or any other blood or lymphatic disease?" The life insured died of leukaemia in January 2012. The court held that the insured knew the fact that the life insured suffered from leukaemia and concealed that fact, so the failure to comply with the duty of disclosure was intentional. The insurer would not have entered into the contract had the insurer known the undisclosed fact, thus the insurer was not liable.

The Insurance Law provides no definition to the term of "gross negligence". The definition of the term of "negligent crime" is provided in the Criminal Law. A negligent crime refers to an act committed by a person who should have foreseen that his act would possibly entail harmful consequences to society but who fails to do so through his negligence or, having foreseen the consequences, readily believes that they can be avoided, so that the consequences do occur.⁴⁸ Gross negligence connotes a significantly higher degree of negligence. Negligence is the opposite of diligence, or being careful. The standard of ordinary negligence is what conduct one expects from the proverbial "reasonable person." By analogy, if somebody has been grossly negligent, that means they have fallen so far below the ordinary standard of care that one can expect, to warrant the label of being "gross."⁴⁹ It is also described as a lack of care that even a careless person would use.⁵⁰

In relation to the nature of the conduct required to constitute gross negligence, the United States Supreme Court in a motor case of *Conway v O'Brien*,⁵¹ cited with approval a description of gross negligence in the following term: "Gross negligence is substantially and appreciably higher in magnitude and more culpable than ordinary negligence. Gross

⁴⁶ Art.5 of the SPC Interpretation.

⁴⁷ This case was decided by the Intermediate People's Court, Yuxi City, Yunnan Province, Civil Court Judgement (2012) No 550, and is reported in *the Annual Report of the Typical Insurance Cases* (Law Press China, 2013) Vol 5, p19.

⁴⁸ Art.15 of the Criminal Law of China.

⁴⁹ See the Wikipedia at http://en.wikipedia.org/wiki/Gross_negligence.

⁵⁰ L.H. Fang, *Insurance and Law* (Press of Beijing University, 2009), p264.

⁵¹ (1941) 312 US 492.

negligence is equivalent to the failure to exercise even a slight degree of care... It is very great negligence, or the absence of slight diligence, or the want of even scant care.”⁵² Similarly, in *Grill v General Iron Screw Collier Co*,⁵³ Willes J famously observed that gross negligence is ordinary negligence with a “vituperative epithet”.⁵⁴

Though the Insurance Law provides no definition to the term of “gross negligence”, in practice, Chinese courts find a gross negligent non-disclosure of material facts in the following situations.⁵⁵

- (1) The insured failed to know the materiality of the relevant facts due to his gross negligence.

The Insurance Law adopts inquiry-based disclosure; the insured is obliged to disclose only the facts which are inquired by the insurer in questions in proposal form. The insured has no duty to volunteer information to the insurer.⁵⁶ Sometimes, even if the insurer puts questions in the proposal form, the insured failed to understand the meaning of the question due to his gross negligence, therefore failed to disclose the material facts to the insurer, this constitutes gross negligent non-disclosure.

- (2) In some situations, although the insured knew the relevant facts and also knew that the facts are material, he failed to disclose the material facts to the insurer due to his gross negligence. Sometimes the insurer’s agents sell insurance products in an inappropriate manner. The agent fills the proposal form and answers the questions raised in the proposal form, and then, asks the insured to sign the completed proposal. According to art.3 of the SPC Interpretation, in the situation where the insurer or his agent completes the proposal form, the insured then signs the proposal, the content provided by the insurer or the agent is treated as the real representations by the insured himself. If the insured does not read the completed proposal form but simply signs it, he may not be able to find any inconsistency between what was put in the form and what was true in reality. Thus the insured is deemed to fail by gross negligence to disclose the true facts which he knew, but not intentionally as the insured has no subjective intention to mislead the insurer to make a wrong judgement and decision to the proposed contract.

⁵² Ibid at 495. The definition was the accepted Vermont definition of gross negligence found in *Shaw v Moore* 104 Vt 529.

⁵³ (1866) 35 LJCP 321.

⁵⁴ Ibid at 330.

⁵⁵ X.M. Xi, *Understanding and Application of the Supreme People’s Court Second Interpretation on Certain Questions Concerning the Application of the Insurance Law of the Peoples’ Republic of China* (the People’s Court Press, 2014), p156.

⁵⁶ Art. 16(1) of the Insurance Law.

The following two cases explain how courts find gross negligence. In *Mrs Zhang v the Life Insurance Company Beijing Branch*,⁵⁷ Mrs Zhang effected a life policy on the life of her uncle in September 2010.⁵⁸ In the proposal form, a number of questions about the state of the life insured's health were raised: (1) "In the last three years, has the life insured been founded any physical abnormality by medical examination? (2) "In the last one year, has the life insured visited any hospital for medical tests, received any treatments and taken any medicine?" The insured answered the questions in the negative. The life insured died from gas (carbon monoxide) poisoning in March 2011. After the life insured's death and upon being inquired by the insurer, Mrs Zhang told the insurer that she took the life insured for a medical examination in a hospital in Beijing in July 2010 and there was no abnormality of the life insured's health. Based on the information provided by Mrs Zhang, the insurer further investigated the case and found from the medical examination report from the hospital that the life insured's blood cells number decreased and the doctor advised him to have a further test. The insurer refused the claim by reason of the insured's failure to disclose the material fact. According to the normal practice of underwriting, the insurer would not issue a life policy if the life insured was found any abnormality in blood test. Mrs Zhang said that the proposal form was filled by the insurer's agent. She was asked by the agent to sign the proposal. She did not read the proposal but signed it. The court noticed that the insurer would not have discovered the life insured's blood test abnormality had Mrs Zhang not told the insurer after the death of the life insured the fact that the life insured had taken a medical examination and the details of the hospital where the medical examination was carried out. This can show that Mrs Zhang did not intend to conceal the material fact in order to mislead the insurer intentionally, and her statement that the insurer's agent filled the proposal form and she did not read the proposal should be accepted as being true. Thus it was held that the insured's failure to disclose the material fact was not intentional but by gross negligence. The "gross" negligence in this case is reflected by the facts that if the insured had taken a little care to read the proposal, she should have found the misrepresentation made by the agent. It was also held that according to art.16(5) of the Insurance Law, in the case of gross negligence, if the undisclosed fact has a material impact on the occurrence of the insured events, the insurer is not liable for paying insurance benefits in connection with the insured events that occur prior to the rescission of the contract. In this case the life insured died of gas poisoning

⁵⁷ This case is reported in the book by J.X Liu, *Typical Cases and Adjudgement Consideration of Insurance Law* (Law Press China, 2012) p269.

⁵⁸ She had an insurable interest on her uncle, for more on insurable interest, see Z. Jing, "Insurable interest in life insurance: a Chinese perspective" [2014] JBL 337.

and there was no causal connection between the undisclosed fact (decrease of blood cell number) and the death of the life insured, so the insurer was liable for paying the insurance proceeds.

In *Mrs Zhou v the Insurance Company*,⁵⁹ Mrs Zhou effected on the life of her husband a life policy with cover of hospital expenses in January 2005. The insurer asked questions in the proposal form: “Have you had any blood test for the last two years?” “Have you had any blood disease, or suspected blood disease?” The answers to the questions were negative. In March 2005, the life insured visited hospital. He was suspected to have blood disease which was not confirmed. The insured paid for the hospital expenses. On another occasion in May 2005, the life insured visited hospital again for treatment and was diagnosed with myelodysplastic syndrome. The insured paid for the costs of treatment. In August 2005, the life insured died of leukaemia. It was discovered after the death of the life insured that before the contract was entered into, the life insured visited hospital in March 2003 and was diagnosed with pneumonia and suspected aplastic anaemia. The court held that the insured must then be aware of the blood disease but failed to disclose it to the insurer. As to the question of whether the non-disclosure is intentional or by gross negligence, the court found that in the proposal form, the box to be filled with the communication detail of the life insured’s son and/or daughter was filled with the words “the same as the proposer”. The word of “proposer” is a professional word. Mrs Zhou was lack of insurance knowledge and should not be able to use the word of “proposer”. Moreover, some details about the life insured, such as height and weight of the life insured were incorrect. So all evidence showed that the insured’s statement that the proposal form was not completed by her but by the insurer’s agent and she did not read the proposal but only signed the completed form should be treated as being true. The insured should have read the proposal form before signing it but she failed to do so, so her failure to disclose was held to be by gross negligence. The court went on to find whether there was any causal connection between the undisclosed fact and the occurrence of the insured event. In this case, the insured died of leukaemia and the undisclosed disease was suspected aplastic anaemia. There was an apparent causal connection between the death of the life insured and the undisclosed disease. Thus the insurer was not liable but should return the premium to the insured.

⁵⁹ This case is cited in the book by X.M. Xi, *Understanding and Application of the Supreme People’s Court Second Interpretation on Certain Questions Concerning the Application of the Insurance Law of the Peoples’ Republic of China* (the People’s Court Press, 2014), p157.

Causation

Proof of any connection between the insured loss and undisclosed fact is unnecessary for intentional breach of the duty of disclosure.⁶⁰ However, a causal link must be established before the insurer can be discharged from liability for pre-rescission loss in the case of a grossly negligent non-disclosure.⁶¹

As discussed earlier, Chinese courts interpret the term of a “material impact” as a “causal connection”. The current position in respect of the insured’s failure to comply with the duty of disclosure by gross negligence is that the People’s Courts will not uphold insurer’s repudiation of liability for pre-rescission loss if there is no causal connection between the undisclosed fact and the happening of the insured event.⁶² However, the extent of the causal connection varies according to the guiding rules for handling insurance disputes provided by different courts: The High People’s Court (HPC) of Shandong Province seeks a “causal connection”;⁶³ the HPC of Guangdong Province demands a “direct causal connection”;⁶⁴ while the HPC of Zhejiang Province looks for “the proximate causal connection”.⁶⁵ It is submitted that the “direct causal connection” and the “proximate causal connection” have the same meaning, that is, the loss is indeed caused by the event. As to a simple “causal connection”, some commentators are of the view that a simple causal connection does not look for a very high probability between the happening of the event and the undisclosed fact,

⁶⁰ The insurer is allowed to rescind the contract where there is an intentional breach of the duty (art.16(4) of the Insurance Law).

⁶¹ Art.16(5) of the Insurance Law.

⁶² Art.6(2) of the Guidance of Guangdong Province High People’s Court Concerning Questions of How to Deal with Insurance Disputes 2011. Art.7 of the Guidance of Shandong Province High People’s Court Concerning Questions of How to Deal with Insurance Disputes 2011. Art.7 of the Guidance of Zhejiang Province High People’s Court Concerning Questions of How to Deal with Property Insurance Disputes 2009. It must be noted the guidance enacted by the High People’s Courts is only to guide the lower courts rather than to bind them. These guiding rules have no legal force.

⁶³ See the Guidance of Shandong Province High People’s Court Concerning Questions of How to Deal with Insurance Disputes 2011. Art.7 provides: “People’s Courts shall not uphold the insurer’s repudiation of liability for losses which occurred prior to rescission of the contract on the ground of non-disclosure or misrepresentation where there is no causal connection between the fact undisclosed by the insured’s gross negligence and the occurrence of the insured event”.

⁶⁴ See the Guidance of Guangdong Province High People’s Court Concerning Questions of How to Deal with Insurance Disputes 2011. Art.6(2) states: “Where the insured failed to comply with the duty of disclosure by gross negligence as stipulated in art.16(5) of the Insurance Law, and there is no direct causal connection between the undisclosed fact and the occurrence of the insured event, People’s Courts shall not uphold the insurer’s repudiation of liability on the ground of the insured’s failure to disclose the fact”.

⁶⁵ See the Guidance of Zhejiang Province High People’s Court Concerning Questions of How to Deal with Property Insurance Disputes 2009. Art.7 provides: “Where the fact undisclosed by the insured’s gross negligence was not the proximate cause to the occurrence of the insured event, and there was not decisive causal connection to the insurer’s liability, the insurer’s refusal of liability on the ground of non-disclosure will not be upheld”.

but a certain connection is sufficient, for example, a connection exists between smoking and lung cancer, hypertension and heart-attack, anaemia and leukaemia, hepatitis and liver cancer.⁶⁶ The issue of causal connection is complex and needs further clarification by the SPC.

4. Deficiencies of the law in respect of grossly negligent non-disclosure

The current position for a gross negligent breach of the duty of disclosure, a causal connection needs to be established between the loss and the undisclosed fact if the insurer can refuse to pay the loss which occurred prior to rescission of the contract. The law seems reasonable, but there is a major flaw with it. In some situations, the insurer would not have entered into the contract or would have entered into the contract with a higher premium had he known the undisclosed fact at the time of the contract. The insurer is nevertheless liable for the loss if there is no causal connection between the undisclosed fact and the occurrence of the insured event. Thus the insurer may receive a lower premium but bear higher risk. For example, if the insured paid £1000 annual premium for a death policy for the amount of £40,000. The insured did not inform the insurer the fact that he had high blood pressure at the time of the contract. The insurer would still have issued the policy but would have charged a higher premium of £1300 had he known the fact of hypertension. The insured died of liver cancer. The insurer is liable for the loss, as no causal connection can be established between the death and hypertension. In this situation, the insurer received £1000 premium and paid £40,000 for the loss. The insurer would have received £1300 premium and paid £40,000 for the loss had the insured performed his duty of disclosure. It would be fairer and more reasonable if the doctrine of proportionality should be adopted for this situation. It is suggested that the insurer should be allowed to reduce the amount to be paid on the claim proportionately to the ratio of premium he received and the premium he should have received. Accordingly, the insurer should pay £30,769 ($£40,000 \times £1000/£1300 = £30,769$), instead of £40,000 if the doctrine of proportionality applies.

In English and Australian law, doctrine of proportionality has been adopted. In the CIDRA, for careless misrepresentations, if the insurer would have entered into the consumer insurance contract, but would have charged a higher premium, the insurer may reduce proportionately

⁶⁶ X.M. Xi, *Understanding and Application of the Insurance Law of the Peoples' Republic of China* (China Legal Publishing House, 2010), p90, and J.X Liu, *Typical Cases and Adjudgement Consideration of Insurance Law* (Law Press China, 2012), p274.

the amount to be paid on a claim.⁶⁷ This is also the approach for neither deliberate nor reckless breach of the duty of disclosure for non-consumer insurance in the Insurance Act 2015.⁶⁸

In the Insurance Contracts Act 1984 (Australia), for general insurance, where the insured failed to comply with the duty of disclosure or made a misrepresentation to the insurer before the contract was entered into, if the insurer is not entitled to avoid the contract or, being entitled to avoid the contract has not done so, the liability of the insurer in respect of a claim is reduced to the amount that would place the insurer in a position in which the insurer would have been if the failure had not occurred or the misrepresentation had not been made.⁶⁹

5. Recommendations for amendment of the law

Have discussed the shortcomings of the current law in respect of remedies for grossly negligent breach of the duty of disclosure at the time of the contract, recommendations are worked out for amendment of the law as follows:

(1) For a grossly negligent breach of the duty of disclosure by the insured:

- (A) Where the insurer can show a causal connection between the occurrence of the insured event and the material fact undisclosed or misrepresented, the insurer shall not be liable for the insured events which occurred prior to the rescission of the contract, but shall refund the premium paid.
- (B) Where there is no causal connection between the occurrence of the insured event and the material fact undisclosed or misrepresented,
 - (a) if the insurer would not have entered into the contract had he been informed by the insured of the material fact, the insurer shall not be liable for the insured events which occurred prior to the rescission of the contract, but shall refund the premium paid;
 - (b) if the insurer would have entered into the contract, but would have charged a higher premium had he been informed by the insured of the material fact, the insurer may reduce the amount to be paid proportionately to the ratio of premium he received and the premium he should have received.

⁶⁷ Para.7, schedule 1 of the CIDRA.

⁶⁸ Para.6, schedule 1 of the Insurance Act 2015.

⁶⁹ S.28 of the Insurance Contracts Act 1984.

(2) It is also suggested that the Insurance Law should provide definitions for the terms of intentional and grossly negligent non-disclosure or misrepresentation. Recommendations for the definitions are as follows:

- (A) A non-disclosure or misrepresentation is intentional if the insured (a) knew the existence of the fact in question,⁷⁰ (b) knew that the fact was relevant to the insurer, and (c) knew that his answer to the question was untrue or misleading, with the intention that the insurer acted on it in the sense that it induced the insurer to enter into the proposed contract.
- (B) A non-disclosure or misrepresentation is grossly negligent⁷¹ if the insured (a) did not care whether or not it was untrue or misleading, (b) did not care whether or not it was relevant to the insurer, but (c) had no intention that the insurer acted on it in the sense that it induced the insurer to enter into the proposed contract.⁷²

6. Conclusions

This article has considered the insured's duty of disclosure and the remedies for breach of the duty in Chinese Insurance Law as compared with those in English Law. By comparison of Chinese law and English law in respect of remedies for breach of the duty of disclosure or representation, the same approach in Chinese law and in English law has been taken for intentional (deliberate) breach of the duty, this is, the insurer is entitled to rescind the contract and retain the premium paid. The CIDRA entitles the insurer to avoid the contract and retain premium paid for a reckless breach of the duty, while Chinese law provides milder remedies for grossly negligent breach: the insurer is entitled to rescind the contract but must refund the premium paid, and he is liable for losses which occurred prior to the rescission of the contract if there is no causal connection between the occurrence of the insured event and the undisclosed fact. It seems that the remedies in Chinese law appear to be more protective to the insured who has less bargaining power in an insurance negotiation, but there are shortcomings and omissions in respect of remedies for breach of the duty in Chinese law.

As discussed earlier, the remedies for pre-rescission losses in the case of a grossly negligent non-disclosure which has no material impact on the occurrence of the insured event is flawed. In this situation, the insurer may receive lower premium but bears higher risk if the insurer

⁷⁰ Art.5 of the SPC Interpretation.

⁷¹ This refers to the definition of reckless misrepresentation in s.5(2) of the CIDRA.

⁷² J.X Liu, *Typical Cases and Adjudgement Consideration of Insurance Law* (Law Press China, 2012), p274.

would not have entered into the contract or would have done so but charged a higher premium. In order to strike the balance between protecting the insured and being fair to the insurer, it is recommended that the insurer's remedies for losses which occurred prior to the rescission of the contract in the case of a grossly negligent non-disclosure which has no material impact on the occurrence of the insured event should be based on what the insurer would have done had the insured complied with the duty of disclosure.

Another flaw in Chinese law is that the law does not provide definitions for the terms of intentional or gross negligent non-disclosure or misrepresentation. This has given rise to uncertainty and judicial difficulties. Different courts may give different decisions for similar cases. So it is necessary to introduce a provision into the Insurance Law to define the terms of an intentional non-disclosure and a grossly negligent non-disclosure. Recommendations for the definitions of the terms have been put forward with reference to the judicial practice in China and to the English approach in the CIDRA and in the Insurance Act 2015.